Intrastate Crowdfunding Through the Invest Georgia Exemption

A guide for entrepreneurs and small businesses in Georgia who want to raise capital

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Chapter 1 The Crowdfunding Revolution

The idea of crowdfunding is causing a revolution in the market for capital, affecting small businesses and new business start-ups. Dozens of books have been written on the subject and there are numerous sites on the Web that provide information on crowdfunding and others that hope to play a role as "crowdfunding portals" in the near future. Despite all this information, however, there is still a great deal of confusion about what crowdfunding is and what it is not. This book hopes to clarify crowdfunding for you and to provide some practice steps for a certain type of crowdfunding that is now possible for small businesses located in Georgia and for investors who are Georgia residents.

What is Crowdfunding?

Crowdfunding is the idea that a large group of people, with access to information, can reach accurate and effective investment decisions even if that large group of people includes individuals who have no formal training in making investment decisions.

Much of the popular discussion of crowdfunding got its start in 2005 when James Surowiecki published The Wisdom of Crowds, a book that described the psychological and social underpinnings behind the idea that crowds can make wise choices.

One example he describes in the book takes place at an English country fair in the late 1800s. At the fair there is a contest to see who can guess the weight of a prize bull. For a modest fee anyone in the crowd can place a bet on the weight (with the closest guess winning a cash prize). At the same time, the fair has put together a panel of experts in farming and animal husbandry to make their own guesses. It turns out that the average of all of the guesses from the crowd were closer to the truth than the best guess of any of the experts on the panel.

This anecdote, and others that Surowiecki tells in his book, demonstrate how crowds, through the exchange of information and the inherent averaging that takes place when large numbers of people make informed guesses, can arrive at decisions that are more accurate than the individual guesses of experts in the field.

In the first decade of the new century several websites and other enterprises tried to take advantage of the wisdom of crowds. A prime example of this trend is Wikipedia (www.wikipedia.org). Wikipedia is a non-profit organization that has developed an online encyclopedia entirely through the volunteer efforts of many thousands of individuals. The Wikipedia system allows individuals to author and edit entries in the online encyclopedia. Authors and editors are required to document the pieces that they write with online references. Through an iterative editing process, the Wikipedia encyclopedia has become an authoritative reference work that millions of people use each day, all without any official authors or experts.

Building on the success of Wikipedia, other websites organized around the idea of "crowdsourcing". Some websites arose to provide people with useful information, while others focused on helping to connect individuals with particular needs with individuals who could service those needs.

Craig's List (www.craigslist.com) is an example of a crowdsourcing website. Craig's List was created by entrepreneur Craig Newmark in San Francisco in 1995 as a way to use the Web to help individuals identify service providers that had been vetted or approved by prior customers. By 2000 the effort had become a commercial venture with its own management team. Through Craig's List an individual in any of the covered metro areas can find home service providers, or list items for sale, and know that they will be able to access a large number of people. Individuals who have purchasing experiences with the vendors who list their services in the website are able to comment (positively or negatively) on the service they received. Over time, the website has developed into a method that allows individuals to benefit from the collective experience of millions of other people.

As examples like this began to grow in the early 2000s, highlighted by James Surowiecki in his book, entrepreneurs began to ask whether the wisdoms of crowds could be harnessed to help individuals raise capital for businesses.

Two early examples of this phenomenon are Indiegogo (www.indiegogo.com) and KickStarter (www.kickstarter.com). Both Indiegogo and KickStarter allow entrepreneurs to advertise their new businesses and to ask for donations from consumers and others who are interested in their projects. Entrepreneurs include musicians, writers, new websites, charities and for-profit ventures. Promoters will describe their new ventures, describe the values that will be generated by the new venture and then ask viewers to make a contribution.

Contributors might get listed on a website, a t-shirt, some merchandise or a coupon that can be spent on the new venture's products or services.

Indiegogo and Kickstarter both claim to have raised millions of dollars for their entrepreneurs. KickStarter, in particular, claims to have raised more than $714 million since its launch in 2009, involving more than 4.5 million individual donors and funding more than 45,000 projects.[1]

As the idea of crowdfunding progressed, more and more entrepreneurs began to question whether it would be possible for new ventures and small businesses to raise funds by having the new ventures sell securities to potential investors over the Web through crowdfunding website platforms.

<u>Background: Securities Law 101</u>

Before you can understand crowdfunding, you need to know a little about securities laws in the U.S. After all, crowdfunding is nothing more than a new way legally to sell securities. But what is a security?

While an introductory class on securities in law school might spend a month on the question, in its simplest terms, a security is any indicator of ownership in a business or a financial asset. The most common type of security is stock, which represents an ownership interest in a corporation. Partnerships and limited liability companies also have ownership interests, which are sometimes called "partnership units," "membership interests" or "membership units." These securities, which represent an ownership stake in the profit of a business, are generally called "equities" since they represent the equitable ownership of the business.

A debt instrument is also a security. If you borrowed money to buy a house, you probably signed a "promissory note" at the closing. That promissory note was a security. When a corporation issues "bonds" or "debentures," they are also securities. Bonds can also be issued by state and municipal governments (sometimes called "muni bonds") or by the federal government. These securities are generally called "debt" securities since they represent a promise by the borrower to pay a fixed amount (called the "principal") plus a charge for the use of the money (called the "interest") over time in certain installments.

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[1] KickStarter.com website. Last reviewed July 22, 2013.

The important thing to remember is that both debt and equity are securities that are subject to regulation in the U.S. both at the federal and state levels.

Federal Law Governing Securities

The chief federal laws governing securities are the Securities Act of 1933 (the "1933 Act") and the Securities Exchange Act of 1934 (the "1934 Act"). The 1933 Act and the 1934 Act were both Congressional reactions to the great stock market crash of 1929. The thinking at the time was that the markets had become overheated, in part, because of an influx of new, small investors who had been solicited by unscrupulous brokers. Among the reforms contained in the 1933 Act and the 1934 Act was a general prohibition on sales of securities unless those securities had been registered with the SEC or were subject to an exemption.

Registration means that the company issuing the securities (known to securities professionals as the "issuer") had to file a registration statement with the Securities and Exchange Commission ("SEC"). The vast majority of publicly-traded companies (i.e., the ones whose stock can be bought or sold through the NASDAQ and NYSE stock markets) at one point filed a registration statement as part of an initial public offering (or "IPO").

Registration statements are long, detailed documents, usually running 150 pages or more in length. The IPO process usually takes a year or more to complete, as a business must pull together several years' worth of audited financial statements and prepare a detailed registration statement that describes its business in detail, the securities it is proposing to sell through the registration statement and the various "risk factors" that an investor should consider when making a decision to invest in the security.

Because the registration process is both expensive and time-consuming, most small businesses and new ventures raise growth capital through private transactions that take advantage of one of the available exemptions from registration.

The Private Offering Exemption

The statutory exemptions to the general federal obligation to register securities are set forth in Sections 3 and 4 of the 1933 Act. Statutory exemptions include everything from sales of stock in certain banks to sales of stock in purely intrastate transactions (i.e., Section 3(a)(11)) of the 1933 Act). Section 4(2) of the 1933 Act exempts sales of securities in a transaction that does not involve a public offering.

This last exemption is somewhat vague, since the statute does not define "public offering." To eliminate the ambiguity, the SEC eventually adopted Regulation D, a set of regulations that provide clarity as to what is a "public offering" and that create safe harbors for certain kinds of non-public transactions. Among those safe harbors is a safe harbor for private sales of securities to an "accredited investor," defined in Rule 501 of Regulation D to include an individual person with either (a) income of $200,000 or more for two or more consecutive years ($300,000 if married and filing jointly) and with the expectation of achieving at least that level of income in the current year, or (b) a net worth of $1 million or more (excluding the individual's primary residence).

Private offerings under Regulation D are the method most start-ups and small businesses have used to raise funds for the past 50 years. Regulation D will provide an exemption for a private sale of securities to accredited investors. The exemption is fairly easy to satisfy so long as all of the investors are accredited, the issuer files a Form D with the SEC (which is a very basic document that requires minimal information regarding the issuer and the securities being offered) and the issuer avoids any public solicitation or general advertising of the offering.

While many start-ups and small businesses have relied on Regulation D to raise funds in private offerings, the prohibition on public solicitation or general advertising has become harder to understand and implement with the advent of the Internet. Before the Web, private offerings under Regulation D were made by word of mouth, through prior relationships and from trusted referrals. With the easy availability of mass communication made possible by the Web, entrepreneurs have struggled to understand why they can't simply advertise the availability of their offerings on their websites and through social media like Facebook, Twitter and LinkedIn.

It is this intersection between mass communications over the Web and the theory that large numbers of people with access to information can make accurate estimates and decisions that makes possible the idea of crowdfunding and that found its legislative incorporation in the JOBS Act of 2012.

Crowdfunding and the JOBS Act

As the idea of crowdfunding took root and in an attempt to spark greater job creation in the aftermath of the great recession of 2007-2009, Congress in 2012 enacted the "Jumpstart Our Business Startups Act" ("JOBS Act") to make it easier for small businesses to raise funds through securities offerings. Among the new ideas implemented in the JOBS Act was a new exemption under the 1933 Act that would permit the crowdfunding of securities offerings.

The JOBS Act was passed by the House of Representatives in March 2012 with an overwhelming vote of 380 to 41. The measure had previously passed the Senate with a bipartisan majority. President Obama signed the Act a few days later calling it a "game-changer" and that the measure "represents exactly the kind of bipartisan action we should be taking in Washington to help our economy."

The JOBS Act amended the 1933 Act in several respects, including by creating a new exemption from registration to allow a small business to raise funds via sales of securities directly to the public through a "crowd-fund portal." This new entity - the crowd-fund portal - was to be defined by regulations promulgated by the SEC. According to the President, "Because of this bill, start-ups and small business will now have access to a big, new pool of potential investors -- namely, the American people. For the first time, ordinary Americans will be able to go online and invest in entrepreneurs that they believe in."

Among other changes to securities laws, the Act opened the door for private companies to publicly advertise the availability of investment opportunities in their securities (a practice known as "solicitation" and previously banned under the Securities Act of 1933). Removing the ban on solicitation was intended to make it easier for private companies to locate potential "accredited investors" who would be qualified to invest in exempt offerings of their securities under Regulation D.

Knowing that it would be necessary for the SEC to promulgate regulations to implement these changes, Congress specifically obligated the SEC to adopt rules promptly. In Section 201 of the Act Congress required the SEC to "revise its rules" with respect to the ban on

Regulation D solicitations "not later than 90 days after the enactment of this Act."[2]

Also, in Section 301 of the Act, Congress required the SEC "not later than 180 days after the enactment of this Act" to issue such rules as may be necessary to carry out the amendments regarding crowdfunding contained in Section 301 of the Act.

Despite these clear instructions, more than a year after the adoption of the JOBS Act the SEC has still not adopted rules to define a “crowd-fund portal” or to otherwise allow issuers to undertake crowdfund offerings in the way they were contemplated by the JOBS Act.

Because of this delay, several states, including Georgia, have adopted rules (both through regulatory change and through legislation) to allow various kinds of crowdfunding on an intrastate basis (i.e., where both the issuer of the securities and each investor are residents of the same state). This kind of crowdfunding (generally called “intrastate crowdfunding”) takes advantage of an exemption in federal securities laws that exempts from the coverage of federal law securities offerings that are entirely between an issuer and investors who resident in the same state.

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[2] The SEC finally adopted rules that lifted the ban on general solicitation in Regulation D offerings on July 10, 2013. Those rules are slated to come into effect on September 23, 2013, more than nine months after the Congress’ original December 31, 2012 deadline.

Chapter 2 Intrastate Crowdfunding through the Invest Georgia Exemption

The Georgia Commissioner of Securities, anticipating a need to reform the state's securities laws to allow some form of crowdfunding, adopted a regulatory exemption for intrastate crowdfundings in November 2011 under a rule it named the "Invest Georgia Exemption" (or "IGE").

After it was amended several times, most recently in December 2012, the IGE allows a company that is organized in Georgia (which may be a corporation, partnership or limited liability company) to raise up to $1 million per year in a crowdfunded offering that consists entirely of Georgia residents.

As part of the IGE offering:

1. The issuer of the securities must be a for-profit entity that is formed under the laws of the state of Georgia and registered with the Georgia Secretary of State (Rule 590-4-2-.08(1)(a));
2. The transaction must fall within the intrastate exemption offered by Section 3(a)(11) of the 1933 Act and the safe harbor provided in SEC Rule 147 (Rule 590-4-2-.08(1)(b));
3. The sum of all cash and other consideration received for all sales of the security through the IGE must not exceed $1 million (after taking into account all sales under the IGE during the preceding 12 months) (Rule 590-4-2-.08(1)(c));
4. No single investor may invest more than $10,000 unless that investor is an accredited investor (as defined in Regulation D) (Rule 590-4-2-.08(1)(d));
5. Funds received must be deposited in a bank or depository institution authorized to do business in Georgia and funds must be used in accordance with representations made to investors (Rule 590-4-2-.08(1)(e)); and
6. Before any general solicitation or the twenty-fifth sale of the security, whichever occurs first, the issuer must file a notice with the Georgia Commissioner of Securities that specifies that securities are being offered under the IGE and that notice must contain the name and address of (a) the issuer, (b) all persons who will be involved in the offer or sale of securities, and (c) the bank or other depository institution in which investor funds will be deposited. (Rule 590-4-2-.08(1)(f)).

An issuer planning to rely on the IGE to offer its securities must be an operating company, one that will generate revenue through the sale of products or services, and not an entity that will make investments in others so that it would fall into the definition of an "investment company" as defined in the federal Investment Company Act of 1940. (Rule 590-4-2-.08(1)(g)).

The issuer must inform all purchasers of its securities that the securities have not been registered under the 1933 Act and instead are exempt under the IGE. The issuer must inform all purchasers that the securities are subject to the limitation on resales contained in SEC Rule 147(e). (Rule 490-4-2-.08(1)(e)).

The issuer may not use the IGE in conjunction with other exempt sales of securities, except for offers and sales to (a) an officer, director, partner or trustee or an individual occupying similar status or performing similar functions, or (b) a person owning 10 percent or more of the outstanding shares of any class of securities of the issuer. (Rule 490-4-2-.08(2)).

The IGE may not be used if the issuer is subject to a disqualifying event as specified in Rule 590-4-2-.06. (Rule 590-4-2-.08(3)).

Preparing an IGE Offering

In order to offer its securities for sale under the IGE, a start-up company or other potential issuer should take great care to review the IGE with an attorney who is familiar with securities laws generally and the IGE in particular. Because the IGE is a relatively new development, there are many experienced securities attorneys who are not yet familiar with this new rule.

As with most other securities offerings, a first step in the process will be for the issuer to develop a business plan, a financial forecast, and a description of the way in which it would spend the cash it hopes to raise in the offering.

The business plan should describe the business, how the issuer creates and delivers its products and services, how it sells products and services to its customers, its overhead and other costs of doing business, and how it generates profits (or hopes to do so in the future). This is a demanding exercise and will usually take many revisions, as pieces of the business plan are developed, thought through and refined.

The financial forecast should account for the issuer's past financial performance if the issuer is already operating. If the issuer is a start-up and has no past performance, the financial forecast will be nothing more than a forward-looking projection. The financial forecast should be sufficiently detailed so that an investor can understand what it will cost to run the business and how the issuer hopes to generate a profit, but not so detailed that a reader gets lost in unnecessary details.

The description of the use of funds should also be sufficiently detailed so that investors know how their money will be spent, but not so detailed that that the description becomes a straitjacket for the issuer. Importantly, the IGE specifies that funds raised in an IGE offering must be used "in accordance with representations made to investors." (Rule 590-4-2-.08(1)(e)). As a result, a description of the use of proceeds ought to strike a balance between descriptive detail and the need for the issuer to have some flexibility in managing its cash.

By way of example, a description of the use of funds that specifies particular purchases and that leaves no room for error would probably be too specific. Even a small deviation might raise the possibility that funds were not being spent "in accordance with representations made to investors." A better description would probably identify major categories of expense (such as product development, payroll, purchases of computer hardware, marketing and advertising, legal and accounting fees, and working capital). By identifying expense items by category, the issuer leaves itself more flexibility as it spends the cash raised in the IGE offering.

<u>The Private Placement Memorandum</u>

Another document that most issuers of securities under the IGE will want to create is a private placement memorandum, or "PPM." Although the IGE does not specifically require issuers to provide investors with a PPM, a PPM is a good idea for several reasons.

One of the chief reasons is that the individuals who are involved in promoting a sale of securities in a private offering (both under federal law as well as under Georgia law) can have personal liability if any of the representations made to investors in that offering turn out to be materially inaccurate. Smart entrepreneurs will use a PPM to define clearly what representations are being made to investors and what potential representations are excluded.

A well-crafted PPM will make a series of specific statements to investors about those facts that are material (or relevant) to a decision to invest in the issuer. For example, the PPM might state that the issuer is duly organized (as a corporation or a limited liability company, etc.) under the applicable state law. If the issuer's business depends upon a particular patent or item of intellectual property, the PPM might make some statements about that patent or item of intellectual property, describing its status under the law, whether it is owned by the issuer (or licensed by the issuer) and whether there are any significant restrictions on the issuer's ability to utilize the intellectual property. The specific statements made in an issuer's PPM will depend on the issuer's business and will generally be related to the issuer's business and its assets.

A well-written PPM will distinguish the express representations that the issuer is making from those "forward-looking statements" that the issuer is making to its investments. A forward-looking statement is a description of what the issuer hopes or expects to happen in the future. For example, in a financial forecast, the issuer might forecast that it is going to sell a certain number of units in a future year and the forecast might predict the gross revenues the issuer hopes to generate and the resulting net profit. While the issuer (and its promoters) might sincerely believe that forecast to be an accurate guess, they should acknowledge that it is only, at best, an educated guess. That kind of educated guess is what securities lawyers call a "forward-looking statement."

Forward-looking statements have a special status in securities law. In general, an investor in a security who experiences a loss of her investment may have a cause of action (or a right to sue) the issuer of the security (or the promoters of that issuer, generally including its officers, directors and certain significant shareholders) if the issuer made a material mis-statement of fact. A "material" mis-statement is one that a reasonable investor would have considered to be a material to a decision to invest in the security.

By way of example, if an issuer in a securities offering represents to investors that the issuer has more than $10 million of cash in the bank (when, in fact, it has none) that misrepresentation is probably going to be viewed by a court as "material" because the amount involved is a significant amount. On the other hand, if a typographical error in the issuer's financial statements is off by a dollar, that kind of mis-representation would probably be viewed as not material.

A well-constructed PPM will contain a notice to investors that the document contains forward-looking statements regarding the future. That notice will describe them with as much specificity as possible. The notice might draw investors' attention to the use of words like "expects," "hopes" or "believes" as indicating that a statement is forward-looking. The notice might also state specifically that financial forecasts and projections of expected revenues, expenses or profits for future periods are forward-looking statements. By doing this, a PPM helps to insulate the issuer and its promoters from liability in the event that a statement in the PPM turns out to be incorrect because an unhappy investor will not be able to claim that he or she relied on the forward-looking statement as if it were a guarantee or a promise as to a future occurrence.

A good PPM will also identify specifically those documents that investors should rely upon when making an investment decision. Generally, those favored documents will either be listed in the PPM or attached as exhibits to the PPM. When identifying those documents that can be relied upon, the PPM should stress that investors should not rely on any other documents, presentations or discussions that anyone (including the issuer's promoters) may have made. By doing this, the PPM helps the issuer and its promoters clarify and narrow the number of documents and potential representations on which investors can rely. This tactic generally makes it more difficult for an aggrieved investor at a later date to claim that he or she relied upon a stray document or statement that made specific promises about the future in a way that was not covered within the PPM.

A PPM is a significant document and will usually take many hours to prepare. While the format and layout of the document includes legal boilerplate (meaning statements and language that can apply in different situations) a PPM is most helpful when it is carefully prepared by an attorney who is familiar with the issuer and with securities laws. Some websites and consultants might offer "template" PPMs, claiming that non-lawyer entrepreneurs can use them to create a PPM that will serve the same purpose as a lawyer-drafted PPM; these forms almost always fall flat. From the perspective of a promoter in a securities offering, the value of a PPM as a means of avoiding liability is almost always related to the level of care invested into the document by the promoters and their counsel.

Other Documents and Communications

Companies looking to raise funds through a crowdfund offering will often include a promotional video or slide presentation to help explain their business case to investors. These kinds of presentations are helpful when they explain the value proposition behind the business and how the promoters believe the investments will be a good one for investors.

On the other hand, promotional videos and presentations can also lay the groundwork for litigation if the investment goes bad. Promoters should make sure to have all of their presentations reviewed by counsel with experience in securities matters. Often just a small change in wording is all that is required to change a potentially actionable statement (i.e, one that might result in a lawsuit) into a statement that can safely communicate to investors.

Experienced counsel will also make sure to harmonize or "conform" statements in videos and other presentations to those made in the PPM. While promotional presentations don't need to sound as lawyerly or legalistic as the PPM, even small mis-statements of fact can be important in later litigation if the deal goes badly.

For example, imagine a promotional video from a crowdfund promoter in which the promoter says, "Other players in our industry have been worth $100 million or more within three years of launch and I can guarantee that XYZ.com will do just as well." This kind of a statement creates a high potential for liability if XYZ.com fails to achieve the level of success described.

In contrast, imagine that the promoter instead said, "Other players in our industry have been worth $100 or more within three years of launch. I am going to work as hard as I can to achieve this same level of success." While this statement also makes a comparison to other players in the industry and makes the same $100-million-in-three-years statement as the earlier attempt, it does not guarantee any outcome. The speaker only claims that he will "work as hard as I can" to achieve that outcome. While that is still a bold statement, and one that implicitly sets expectations for a particular dollar amount, it is less likely to result in a bad outcome for the promoter than the prior statement.

There is no specific formula for "safe" statements versus "risky" statements in promotional presentations. Perceptions of risk will vary from person to person and industry to industry. Perceptions of risk will also vary based on the nature of the offering, the type of securities involved, and the background and experience of the promoters.

In each offering, however, promoters of the offering would do well to have their promotional presentations and other materials reviewed by a securities attorney who is familiar with the offering and involved in preparing the PPM.

Chapter 3 Top Ten Things to Remember in Your IGE Offering

There is no specific formula for success when it comes to an IGE crowdfund offering. An issuer must have a good business plan with a clear explanation for how the business will succeed and generate profits. The issuer will also need qualified securities law advice to make sure the issuer's offering documents comply with the law and tell the issuer's story in a way that will limit the liability of the issuer's promoters.

Here is a list of ten of the most important things to remember when it comes to putting together an IGE offering.

1. Hire an Attorney Familiar with the IGE Rules

Perhaps the most important item for a start-up to consider is hiring an attorney who is familiar with the IGE rules. The IGE rules are relatively new and even experienced lawyers from large firms may have difficulty handling IGE offerings in a cost-effective manner if they haven't done one before. Experienced lawyers in this space are often able to provide comprehensive services in structuring an IGE offering on a reduced-fee or fixed fee basis.

Ask your attorney whether he or she has handled other IGE offerings in the past before making a hiring decision. Attorneys with experience in the area will often have previously-used forms they can utilize to make the work process efficient and pre-approved checklists to make sure no issues are missed.

2. Pull Together the Issuer's Constituent Documents

The start-up company (or "issuer") is going to need to disclose to prospective investors all of its "constituent documents." For a corporation, this will include the articles of incorporation, bylaws and shareholders agreement (if there is one). For a limited liability company, this will include the articles of organization and the operating agreement. Pull all of your company's constituent documents together and consider whether they will need to be modified before you begin an IGE offering.

3. Catch Up on Corporate House Keeping

In addition to the issuer's constituent documents, there may be other corporate "housekeeping" items that need to be completed. For example, does the issuer have a board of directors? Are all members of the board of directors still engaged with the company and intending to be involved after the IGE offering is completed? Has the issuer paid its taxes and filed all required income tax returns? Are there any outstanding liens on the issuer that should be terminated before the offering begins? (Outstanding liens would probably need to be disclosed).

4. Prepare a Clear and Persuasive Business Plan

While creating a persuasive business plan is more of a business concern than a legal concern, the decision to invest will be a business decision for most investors. Entrepreneurs with start-up issuers should make sure that their business plans are well-considered and thorough. Entrepreneurs will often have their business plans reviewed by experienced business persons or angel investors to spot potential concerns and address them before the offering gets underway.

5. Consider Protections for Minority Shareholders

As part of the corporate housekeeping exercise, the issuer should consider whether it should adopt protections for its minority shareholders. (In this context the word "minority" means a shareholder who owns less than 50% of the outstanding stock which will generally include all of the investors in the IGE offering). Minority protections can sometimes be found in a shareholders agreement (for a corporation) or in an operating agreement (for a limited liability company). Minority protections will usually aim to protect small investors against the influence of large investors. For example, they might require a "supermajority" (or greater than 51%) stockholder approval for significant transactions, such as incurring debt, issuing new equity securities, major sales of assets or mergers of the company. Minority protections can sometimes be important in convincing investors to trust their investment in the issuer.

6. Prepare a Robust List of Risk Factors

An issuer in an IGE offering will prepare a document that makes disclosures about the issuer and the investment opportunity. This can sometimes take the form of a private placement memorandum or similar document. In the disclosure document the issuer should be certain to include a robust list of risk factors (or potential risks that could negatively affect the issuer and the investor's investment). Risk factors might include generic risks (such as the generic risks facing all start-ups like the possible need to raise more money or the risk involved with executing on a business plan) or risks that are specific to the issuer's business plan (such as the risk of a change in regulations for businesses that are subject to regulation, such as those involving insurance, real estate, health care, etc.)

Attorneys with experience in IGE offerings will often have a checklist for preparing a list of risk factors and the ability to identify industry-specific risks for their clients.

7. Adopt a Reasonable Valuation

Before a start-up offers to sell securities in an IGE offering, the company should develop a reasonable view regarding its value and the appropriate value for the securities it is selling. Every entrepreneur has an optimistic view of what a new business might be worth in the future, but putting an accurate price tag on a new venture can be a tricky exercise.

The value that a company has before it takes on investor funds is called the "pre-money valuation." To determine how much of a company must be sold to raise a particular amount, the company needs to determine its pre-money valuation. For example, if a company wants to raise $1 million and only wants to give away 25% of its equity, the company will need to have a pre-money valuation of $3 million. (If the pre-money valuation is $3 million, then new investors adding $1 million in cash will bring the post-money valuation to $4 million and the new investors' money will represent 25% of the whole.

8. Have a Plan for Managing Investor Communications

Remember that if the offering succeeds, the issuer may have several hundred new shareholders to manage. They will want updates on the issuer's progress and management may need to solicit their consent to certain corporate actions (such as an increase in the number of authorized shares). Make sure that the subscription agreement or other documents provided by the investors have accurate contact information. Develop a plan for providing periodic updates to the investors and for keeping their contact information current.

9. Plan to Have a Smooth and Organized Closing

Managing a closing for a crowd fund offer can be stressful. The issuer will want to make sure that each investor's subscription agreement is complete, run through a pre-closing checklist and make sure that certificates get printed, copied to the issuer's records, recorded on the issuer's ledger and then mailed to each of the investors. The crowd funding portal may sometimes also have requirements for conducting the closing and the issuer will need to coordinate with the portal as well as with the escrow agent (if there is one) to make sure that funds can be released at the closing. The best way to manage the closing is to keep track of the subscriptions as they are received, prepare a closing checklist in advance, and keep in close communication with the portal and the escrow agent. Attorneys with experience in IGE offerings can also help ease the stress.

10. Check Down All of the IGE Requirements Before Publishing Your Offering Materials

An issuer in an IGE offering will want to appear to the public as if it has thought everything through and is fully prepared to take on the investment and launch its business. To succeed at this, the best preparation is to actually think everything through. Develop a checklist of all the items needed to publish the offering documents on the crowd funding portal. As issues are raised, add them to the checklist and check them off only when they are fully resolved. Make sure that all of the requirements for the offering, the closing and the post-closing management of the issuer are fully vetted before publishing the offering documents.

Many industry analysts believe that crowd funding will revolutionize the way that start-ups and small businesses raise money for growth capital. That belief is more likely to come true if entrepreneurs, attorneys and other professionals in this space prepare and manage their offerings in a transparent and professional manner. By checking down lists of important issues and ensuring that those issues are resolved, issuers will not only increase their own chances of success but will also help to ensure the success of crowd funding in general.

Chapter 4 Other Crowdfunding Resources

There are a great many websites regarding crowdfunding that provide additional information. While many are maintained by consultants and attorneys who hope to attract clients as crowdfunding catches on, not all websites are entirely accurate.

Here are a few resources that I think you may find helpful.

Government Sources

The Securities and Exchange Commission www.sec.gov

- Securities Act of 1933 http://www.sec.gov/about/laws/sa33.pdf
- Securities Act of 1934 http://www.sec.gov/about/laws/sea34.pdf
- JOBS Act of 2012 http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf
- Rule 147, 17 CFR 230.147 http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&sid=20c66c74f60c4bb8392bcf9ad6fccea3&rgn=div5&view=text&node=17:2.0.1.1.12&idno=17#17:2.0.1.1.12.0.36.32

Georgia Commissioner of Securities http://www.sos.ga.gov/securities/

- Invest Georgia Exemption http://rules.sos.state.ga.us/docs/590/4/2/08.pdf
- Disqualifying Events http://rules.sos.state.ga.us/docs/590/4/2/06.pdf

Industry Groups

Crowdfund Intermediary Regulatory Advocates http://www.cfira.org/

Crowdfunding Professional Association http://www.cfpa.org

About the Author

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Wilson earned his undergraduate degree at the College of William and Mary in 1988, being inducted into Phi Beta Kappa, and his *juris doctor* from George Washington University in 1991. He practiced with several large law firms in Atlanta before serving as an in-house general counsel to Web.com (NASDAQ: WWWW) and EasyLink Services International Corp. (NASDAQ: ESIC). He joined Taylor English Duma in 2009 where he represents businesses ranging from Fortune 500 companies to start-ups in corporate, securities and technology transactions.

Wilson is a frequent writer and speaker on corporate finance and crowdfunding and is a member of the Crowdfund Intermediary Regulatory Advocates (www.cfira.org). He frequently blogs on the Manhattan Institute legal website – www.PointOfLaw.com and has authored or contributed to the following books:

Energy, Utility, Transportation and Environmental Law for the 21st Century: A Collection (contributor) (ABA, 2013)

The In-House Counsel's Essential Toolkit (American Bar Association, 2007) (contributor, Volume 3)

Out of Balance: Prescriptions for Reforming the American Litigation System (iUniverse, 2005)

Internet Forms and Commentary: A Practitioner's Guide to E-Commerce Contracts and the World Wide Web (co-author and co-editor) (American Bar Association, 2002)

Appendix 1 The Invest Georgia Exemption

590-4-2-.08 Invest Georgia Exemption.

(1) The offer or sale of a security by an issuer shall be exempt from the requirements of Article 3 and Section 10-5-53 of the Act, and each individual who represents an issuer in an offer or sale shall be exempt from the requirements of Section 10-5-30, if the offer or sale is conducted in accordance with each of the following requirements:

(a) The issuer of the security shall be a for-profit business entity formed under the laws of the state of Georgia and registered with the Secretary of State.

(b) The transaction shall meet the requirements of the federal exemption for intrastate offerings in section 3(a)(11) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(11), and SEC Rule 147, 17 C.F.R. 230.147.

(c) The sum of all cash and other consideration to be received for all sales of the security in reliance upon this exemption shall not exceed $1,000,000, less the aggregate amount received for all sales of securities by the issuer within the 12 months before the first offer or sale made in reliance upon this exemption.

(d) The issuer shall not accept more than $10,000 from any single purchaser unless the purchaser is an accredited investor as defined by Rule 501 of SEC Regulation D, 17 C.F.R. 230.501.

(e) All funds received from investors shall be deposited into a bank or depository institution authorized to do business in Georgia, and all the funds shall be used in accordance with representations made to investors.

(f) Before the use of any general solicitation or the twenty-fifth sale of the security, whichever occurs first, the issuer shall file a notice with the Commissioner in writing or in electronic form. The notice shall specify that the issuer is conducting an offering in reliance upon this exemption and shall contain the names and addresses of the following persons:

1. The issuer;

2. All persons who will be involved in the offer or sale of securities on behalf of the issuer; and

3. The bank or other depository institution in which investor funds will be deposited.

(g) The issuer shall not be, either before or as a result of the offering, an investment company as defined in section 3 of the Investment Company Act of 1940, 15 U.S.C. § 80a-3, or subject to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m and 78o(d)..

(h) The issuer shall inform all purchasers that the securities have not been registered under the Act and that the securities are subject to the limitation on resales contained in subsection (e) of SEC Rule 147, 17 C.F.R. 230.147(e)

(2) Offers and sales to controlling persons. This exemption shall not be used in conjunction with any other exemption under these rules or the Act, except for offers and sales to the following persons, who shall not count toward the limitation in paragraph (1)(c):

(a) An officer, director, partner, or trustee or an individual occupying similar status or performing similar functions; or

(b) A person owning 10 percent or more of the outstanding shares of any class or classes of securities

(3) Disqualifications. This exemption shall not be available if the issuer is subject to a disqualifying event specified in Rule 590-4-2-.06.

(4) The exemption authorized by this section shall be known and may be cited as the "Invest Georgia Exemption.

(5) "Individual," for the purpose of paragraph (1) of this Rule, means a natural person residing in the State of Georgia, or a corporation, trust, partnership, association, or any other legal entity duly organized under the laws of the State of Georgia, that does not:

(a) offer investment advice or recommendations;

(b) solicit purchases, sales, or offers to purchase the securities exempted by this Rule;

(c) compensate employees, agents, or other persons for the solicitation of purchases, sales, or offers to purchase the securities exempted by this Rule; or

(d) take custody of investor funds or securities.

Authority O.C.G.A. Secs. 10-5-3, 10-5-10, 10-5-11, 10-5-12, 10-5-30, 10-5-70. **History.** Original Rule entitled "Supervision of Salesmen, Limited Salesmen, and Employees" adopted. F. Dec. 9, 1980; eff. Dec. 29, 1980. **Repealed:** New Rule of same title adopted. F. Apr. 13, 1983; eff. May 3, 1983. **Amended:** F. Feb. 24, 1987; eff. Mar. 16, 1987. **Repealed:** New Rule entitled "Criminal History Access" adopted. F. Dec. 21, 2004; eff. Jan. 10, 2005. **Repealed:** New Rule entitled "Invest Georgia Exemptions" adopted. F. Nov. 18, 2011, Dec. 8, 2011. **Amended:** F. Mar. 9, 2012; eff. Mar. 29, 2012. **Amended:** F. Dec. 7, 2012; eff. Dec. 27, 2012.